

VZCZCXRO1663
PP RUEHROV
DE RUEHTV #0036/01 0080826
ZNR UUUUU ZZH
P 080826Z JAN 07
FM AMEMBASSY TEL AVIV
TO RUEHC/SECSTATE WASHDC PRIORITY 8575
INFO RUEHXK/ARAB ISRAELI COLLECTIVE
RHEHNSC/NSC WASH DC

UNCLAS SECTION 01 OF 03 TEL AVIV 000036

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E.O. 12958: N/A

TAGS: PGOV PINR KJUS EFIN ECON KCRM IS
SUBJECT: MAJOR CORRUPTION CASE INVOLVING STATE TAX COFFERS

REF: 2006 TEL AVIV 4742

SUMMARY

¶1. Significant new scandals marked the new calendar year in Israel. Police detained some thirty individuals on allegations of involvement in influence-peddling and bribery within and around the Israel Tax Authority (ITA). Unlike other recent scandals that have focused on sexual harassment cases, campaign finance irregularities or individual allegations of malfeasance, the ITA case promises to be the mother of all recent scandals in Israeli political life. Police investigators do not admit to possession of evidence linking PM Olmert directly to the current allegations against ITA personnel, although his office director is under house arrest. Media reports insist, however, that Olmert may face police questioning along with Finance Minister Hirschson, whose testimony is also sought in connection with a separate investigation of embezzlement from a labor union he headed. Olmert and Hirschson are scrambling to control the damage, and both have urged outgoing Ministry of Finance (MOF) Director General Yossi Bachar to take charge of the ITA on an interim basis.

ITA AFFAIR: THIRTY ARRESTS AND COUNTING

¶2. When the first arrests were made on the morning of January 2nd, the Israeli police went public with an investigation of the Israel Tax Authority that had been in progress for two years. The ITA itself was established by government decision in September 2004, and falls under the authority of the Minister of Finance. Initial press reports indicate that police have detained or placed under house arrest at least thirty persons, including ITA personnel and members of the business community. The ITA's present director, Jackie Matza, was detained on suspicion of taking bribes; his predecessor, Eitan Rob, was detained and released under house arrest in connection with decisions taken while serving as ITA director; businessman Kobi Ben-Gur was detained and is under investigation for exerting influence over Rob regarding ITA appointments; Shula Zaken, manager of PM Olmert's bureau, was placed under house arrest under suspicion of using her influence to secure appointments of tax authority officials, specifically Jackie Matza as director; Yoram Karashi, a Jerusalem City Councilman and brother of Shula Zaken, is suspected of using his connections to senior officials to influence appointments. In addition to those already detained or under house arrest, police investigators are quoted as saying the numbers of those facing questioning will run into the hundreds and that the investigation could extend to the Civil Service Commission which oversees all public sector appointments.

ACCUSATIONS OF PROMOTION PEDDLING FOR TAX BREAKS

¶3. While hourly media updates seek to "advance the story" in classic investigative style, the plain facts of the case are hard to

come by. Police personnel have made it clear that the suspects themselves are not afforded access to all the evidence against them and that more is being concealed than revealed. One media account of the initial remand hearing of Yoram Karashi reported that presiding Judge Mordechai Peled was of the opinion that the evidence submitted indicated that the ITA had been under the criminal influence of both Karashi and Kobi Ben-Gur. According to the same account, police investigators opined that Karashi and Ben-Gur had traded tax breaks for promotion within the ITA and that they knew very well to whom they owed their promotions.

PRIME MINISTER'S AIDE UNDER HOUSE ARREST

¶4. The news of Shula Zaken's house arrest sent the Prime Minister's bureau into what the media called "crisis mode." Shula Zaken has been Ehud Olmert's right-hand office administrator since the start of his career in the Knesset in 1973. Even if released from house arrest, she may not be permitted to return to her post as head of the Prime Minister's bureau. The Movement for Quality Government (MQG) has asked the Attorney General and the Civil Service Commissioner to suspend Zaken, along with that of the ITA directors and officials who are at the center of the current investigation. The MQG argued that a clause in the civil service law gives the commissioner the discretionary right to take such action after consultation with the attorney general. For Olmert, however, the damage has already been done. Zaken is indelibly associated in the public mind with him, and her image on TV screens will repeatedly evoke their association. Olmert's predicament was amply conveyed by Israel Television when it reported that he had phoned Shula Zaken after her release into house arrest, thus demonstrating that he placed loyalty to a friend -- a character trait on which Israelis place a high value -- over the propriety required of him by his

TEL AVIV 00000036 002 OF 003

office.

OLMERT AND HIRCHSON HOPE BACHAR WILL BAIL OUT ITA

¶5. For PM Olmert, the immediate fall-out of the ITA investigation is two-fold. At the local level, his own bureau is handicapped due to Zaken's house arrest. At the national level, Treasury sources have expressed concern that since the ITA affair exploded into the public arena, the authority's employees have stopped working and are in a state of shock. The Treasury sources say this could affect state revenues, though our Ministry of Finance contacts are not yet sounding alarms. Finance Minister Avraham Hirchson, who bears ministerial responsibility for the conduct of the ITA and its detained director, Jackie Matza, appears unable to find a replacement for the man who was appointed by none other than Ehud Olmert, during his term at the Treasury in 2005. Olmert and Hirchson have both reached out to outgoing, and well-respected, MOF Director-General Yossi Bachar to fill in at ITA, but Bachar has not yet committed to do so.

OLMERT AND HIRCHSON HAVE OTHER PROBLEMS TOO

¶6. Olmert and Hirchson have legal problems of their own. According to media reports, the Attorney General will decide, in the coming days, whether to launch a criminal investigation into Olmert's role in the sale of Bank Leumi, while the State Comptroller is to decide whether to recommend a criminal probe into political appointments Olmert is alleged to have made while serving as Minister of Industry and Trade. Hirchson's problems are even more immediate. Press reports say the National Fraud Squad is seeking to question him on suspicion of robbery, fraud and money laundering while serving as head of the National Workers Union. Even the aggressive Israeli press corps has stopped short of speculating just when the Finance Minister will be investigated in regard to the ITA imbroglio, but there is no doubt that such an investigation is anticipated.

SHOOTING THE MESSENGERS

¶7. As pundits, commentators and professional prophets of doom express profound amazement over the landslide of corruption cases and the depth of Israeli malaise, the warning voice of Accountant General Yaron Zelekha reverberated once again this week. Earlier this month, he launched an attack on corrupt practices in government circles that so angered Finance Minister Hirschson that he restricted Zelekha's authority to grant credit to local authorities in the crisis over funding the municipalities. Zelekha's broadside came amid much tension over changes he was making in the work of the Accountant General's office and which he claims triggered enmity and even threats against his person. "We made changes that startled prehistoric beasts sucking the nation's blood," Zelekha declared, winning the opprobrium of many in the Treasury, but garnering praise from another maverick public servant in the person of State Comptroller Micha Lindenstrauss, who is currently engaged in scrutiny of several corruption allegations against the senior political echelon (reftel).

¶8. On January 2, Zelekha appeared before the Knesset Committee on State Control and his statement hinted that he knew of the investigation into the tax authority long before it reached public notice. Certain officials within public service were trying to oust him, he claimed, so that they could steal the public's tax money: "It is my moral and legal duty to divulge their identities to the authorities, and that is what I did. We passed on all information to the relevant authorities immediately."

LIKUD CENTRAL COMMITTEE: CORRUPTION CENTRAL

¶9. Five days of media attention into the ITA imbroglio brought the usual slurry of in-depth dredging of the reservoirs of gossip and hearsay surrounding the investigation and its likely political fall-out. One of the more thought-provoking, albeit provocative columns by Nadav Eyal in Ma'ariv cast readers' minds back to a forgotten institution: The once-powerful Likud Central Committee held sway over Israeli politics for most of the period between 1977 when then-Prime Minister Begin of Likud wrested power from Labor's near 30-year monopoly, until 2005 when Ariel Sharon finally broke with Likud to establish the Kadima Party. The Likud Central Committee has become a byword for corruption and the ties between business interests and government. Nadav Eyal noted that all three central suspects in the ITA investigation are present or past members of the Likud Central Committee, which, in its heyday, claimed to be able to resolve just about any problem it chose, whether it involved VAT, income tax, government tenders or local authority business. Eyal wrote that this explains why Likud is now

TEL AVIV 00000036 003 OF 003

silent on the ITA affair and why most of Kadima -- who are former Likud members -- are likewise keeping quiet.

LEADERSHIP IN THE WINGS?

¶10. In Kadima, however, there is one notable exception. Two opinion polls published as the initial shock waves of the Israel Tax Authority [ITA] investigation were still battering public opinion, brought unwelcome tidings to PM Olmert's already troubled bureau. While a Dachaf poll censured PM Olmert's performance in office, faulting him for lack of integrity, an Israel Radio survey of public opinion placed Foreign Minister Livni as the Kadima voters' favorite should the party leadership slot become available. Foreign Minister Tzipi Livni made it known December 29, in an extensive interview with Ha'aretz that she has her sights set on the premiership. This week she scheduled an unusual meeting for a Foreign Minister -- with local authority heads -- one indication that she is preparing for a possible campaign in the future. Another candidate is quietly preparing to contest the leadership of the Labor Party. Israel Television showed Ofir Pines-Paz of Labor, who left his ministerial

position in the current government over its decision to include Avigdor Lieberman, preparing to launch his campaign for the party leadership contest in late May.

CRETZ